

## **SOUTH ASIA: TRENDS TO 2020**

### **Key Points**

- Economic growth is most likely to continue at existing rates, which would approximately double average per capita incomes by 2020. Southern and western India will become more prosperous but widespread poverty will still be evident in some parts of the region. Population growth rates are dropping but pressure on resources, especially land and water will intensify further.
- This scenario is predicated on governments gradually changing policies that constrain growth. This process could speed up but political systems, heavily influenced by vested interests, are unlikely to allow that.
- Hindu chauvinism is likely to be an increasing force in India. That may make the Muslim minority more susceptible to Islamist influence. The Pakistani military will continue to be inclined to resist Islamist influence but the country will remain politically fragmented.
- Tensions between India and Pakistan are likely to continue and could escalate quickly. International diplomatic efforts may be needed to avoid all out war possibly leading to the use of nuclear weapons. Afghanistan will remain a cause of concern for Pakistan.
- India is building links with East Asia including China and it seems to be taking less rigid approaches in international forums. It may well play an increasingly active and influential role in international affairs.
- Pakistan is drawing closer to the Middle East. Sales of its advanced weapons systems including weapons of mass destruction technology might meet the perceived needs of purchasers in the region and provide export earnings for Pakistan.

## **Introduction**

Plausible scenarios for South Asia over the next 20 years cover a range of possibilities. At one extreme, tensions within and between states are managed successfully, governance improves significantly, and impediments to economic performance are systematically removed. Under such a scenario, living standards could be rising rapidly by the end of the period. At the other extreme are scenarios which involve inter-communal conflict and war between states, including possibly the use of nuclear weapons. The result could well be a chaotic region in humanitarian crisis. The base scenario described in this paper lies somewhere between the two extremes. It postulates a continuation of trends over the last twenty years, with tensions within and between states and modestly but unevenly rising living standards. Factors that might push actual developments towards one of the extremes are examined.

## **Background**

2. The last two decades have seen reasonable economic growth in most South Asian countries, albeit modest by East Asian standards. In India, which accounts for about three-quarters of the population of the subcontinent, real per capita gross domestic product increased by 3.4 percent a year between 1981 and 1991 and by 4.2 percent annually over the next ten years. The implication is that average incomes roughly doubled over the two decades. Nepal and Sri Lanka performed somewhat better on this count, while Bangladesh lagged in the 1980s but picked up in the 1990s. Pakistan grew at about the same rate as India in the 1980s but very slowly in the 1990s. Other development indicators have also shown improvements. In most countries population growth is slowing: the World Bank expects total numbers to increase by about 31 percent to 1.78 billion between 2000 and 2020, after growing by over 60 percent in the preceding 20 years.

3. Economic growth has not been evenly spread. The western Indian states (Gujarat, Haryana, Maharashtra and Punjab) have average incomes some two to three times those in northern and eastern states. Average incomes in southern states are between the two extremes. In recent years, growth has been concentrated in a few sectors, which employ predominately highly educated staff (information technology, telecommunications and financial services), many in the south, which is also the source of a disproportionate number of offshore workers. Indian incomes have almost certainly become less rather than more equal. Between 25 percent (in Sri Lanka) and 42 percent (in Nepal) of people have incomes below national poverty lines.

4. There is a widely held view that better policies over recent years would have increased growth rates in all South Asian countries. India successfully overcame a balance of payments crisis in the early 1990s and somewhat reduced constraints on foreign trade; both imports and exports grew much more rapidly than gross domestic product during the 1990s. There was also some easing of the regime regulating firms, but the regime and its implementation still severely slow and discourage investment. Inadequate infrastructure also constrains economic activity, as do the high cost of capital and the risks posed by India's weak public finances.

5. Domestic politically motivated violence and the effects of conflicts in neighbouring countries have marked the region. But open inter-state conflict has been largely avoided, since 1971, except in Afghanistan.

### **The Base Scenario**

6. Continuation of the trends evident in India over the last 20 years would result in per capita incomes again doubling. The required average annual growth rate of about 3.5 percent together with the World Bank projected population growth of about 1.2 percent per annum imply gross domestic product (GDP) growing by some 4.8 percent a year. This is significantly below the rates observed over the last two decades, when population growth rates were higher. There is potentially enough headroom in India's trend performance to project a doubling of average incomes across the region, even if Pakistan (and possibly Bangladesh) lags, as may well be the case.

7. Demographic and social factors should, on balance, increase growth rates over the next two decades. Slower population rates are expected to cut dependency rates in the region from 65.5 percent in 2000 to 49.4 percent in 2020. Taken together with increasing educational achievement (higher literacy rates and more students going beyond primary school), both the quantity and the quality of the labour force should continue to rise. Harnessing these forces will require the opening up of appropriate job opportunities. Were regional disparities to persist and labour mobility to be constrained (including by social pressures), there could be pockets of labour shortage and other areas with increasing unemployment, including of well educated workers. The latter would be a potential threat to social stability. Further demographic pressure on rural environments and falling qualities of lives in increasingly crowded urban areas could also generate tensions. The effects of HIV/AIDS on population trends, including dependency rates, in South Asia are not yet clear.

8. India's experience over the last two decades demonstrates that modest liberalisation of the economy can have significant effects on economic performance. This base scenario assumes that the authorities further ease the regulatory regime in a way that sustains growth. But the liberalisation envisaged would still be constrained by complex political bargaining and thus be piecemeal and gradual rather than radical or rapid. We see the growth being financed mainly from domestic savings, supplemented by the Indian diaspora who would also contribute disproportionately to technology transfer and the connections needed to build exports of goods and services. This is akin to the role of overseas Chinese with respect to China. We do not envisage other foreign direct investment being the key driver of growth on the subcontinent, especially in the near term; potential investors perceive that projects elsewhere will yield higher returns and be less problematic.

### **The constraints**

9. Public finances, and government management more generally, remain major impediments to growth. Substantial fiscal deficits in India (currently perhaps 10 percent of GDP for the federal and state governments collectively), together with an inefficient financial sector and policies that direct considerable lending to social priority sectors, result in high borrowing costs. This, together with a still rigid regulatory system (and its associated corruption) discourages investment by firms, especially those that are not well connected. Fiscal pressures constrain government investment in infrastructure such as roads and electricity systems needed to support growth. Fiscal deficits have been primarily domestically financed; external debt servicing is generally manageable, at least in the short run, except in Pakistan. Improving public finances would seem to require both revenue enhancement and the reduction of poor quality expenditures (for example on ill-directed subsidies).

10. A general improvement in economic management would, on the face of it, result in GDP growth rates markedly higher than the five percent or so projected in the base scenario. But rapid change is probably not politically feasible: present indications are that none of the South Asian states is likely to have executive branches secure enough to survive the resulting political fallout. Sectors and regions left behind would almost inevitably use political means, both to block reforms that affect their interests and to capture part of the gains.

- National politics in India have acquired regional and religious elements and the centre has only limited control over state fiscal management. Despite this, we see no

signs of moves towards authoritarianism in India; we expect parliamentary democracy to remain largely unchanged.

- Politics in Pakistan are deeply divided and any civilian government would, on past trends, be quickly captured by vested, land owning interests. The Islamic parties are unlikely to be a force for rapid development. Military led governments tend eventually to succumb to the same influences.
- Sri Lanka may be an exception since rapidly rising incomes could be a reconciling force between ethnic groups.

11. Land and water are already under pressure in much of South Asia, especially in India. That will intensify over the next twenty years as populations rise and surface and ground water is increasingly polluted. Tensions over water could increase, both within and between countries. Imported food could reduce some of these pressures, especially in intensively irrigated areas, but would intensify political opposition to structural change. Internal migration could ease some of the pressures on rural land and water but would also accentuate social problems, especially in cities. Periodic flooding will remain a problem for Bangladesh.

### **Domestic tensions**

12. Realisation of the base scenario would result in western and southern Indian states continuing to grow more quickly than those in eastern and northern India. This would further widen gaps between the states. Resource transfers might somewhat alleviate the likely sense of deprivation in the lagging areas but could, in turn, generate some grievance in the leading states. The latter could be accentuated by the likely failure of the central authorities fully to implement the policies that would maximise growth. The resulting tensions are likely to be resolved through existing political structures since the dynamic areas gain economic and security benefits from the larger Indian state able strongly to influence an uncertain region. Disputes over resources, including differences over leased land may involve violence but will almost certainly remain localised. And minorities in the northeast and in Kashmir continue to harbour secessionist sentiments.

13. Hindu chauvinism is likely to be an increasing force in India. That will inevitably further alienate the Muslim minority, possibly making it more susceptible to external Islamist influence. Until now Islamist terrorism in India has been predominately associated with the Kashmir dispute; that could change, with potentially serious consequences for Indian domestic security. Despite Prime Minister Vajpayee's inclination to improve relations, the Hindu influence now

evident in Indian politics reinforces the religious element in tensions with Pakistan (and potentially Bangladesh).

14. Developments in Pakistan will continue to reflect complex interactions between the landowner dominated areas of the Indus river valley, the 1947 refugees from India and their descendants who are disproportionately located in Karachi, and the tribal peoples based in North West Frontier Province (NWFP) and Baluchistan. The latter tend to be militantly Islamic and some have close connections with the Pashtuns of Afghanistan. The resulting lack of cohesion makes governance of Pakistan particularly fraught especially with the landowners divided. The military is the only strong national institution and is likely to continue to play a key role in governance even after Musharraf vacates one of his positions. We see no signs that Pakistan will soon emerge as a more cohesive state under a civilian administration, able to foster the development needed to raise living standards sharply, and willing to reach an accommodation with India. Given past failures of governance, Islamist influence could grow to dominate the country, although the military would be inclined to resist, and Punjabi and Sindhi leaders would not easily surrender their leading political role.

15. A ceasefire was concluded in Sri Lanka in February 2002 and appears to be holding. Sri Lanka has a number of favourable conditions for growth (particularly an educated workforce and an inclination to be outward looking). By 2020 Sri Lanka could much more resemble the Southeast Asian countries than the rest of South Asia. Rapid growth would help lock in peace.

### **Inter-state conflict in the region?**

16. Kashmir remains the focus of tension between India and Pakistan, although disputes could also arise over water flows in the Indus River. Neither side is inclined to back down over Kashmir and, in fact, could not do so without risking considerable political damage. Pakistan is unlikely directly to attack Indian controlled Kashmir but will continue to facilitate militant activities and to provide some military backing at the border. Such support would probably increase were Islamists to gain greater political influence in Pakistan or if the military were somewhat alienated from a weak civilian government.

17. So long as militant activities are largely restricted to Kashmir and do not threaten its control of the area, India would probably avoid significant military incursions into Pakistan, although it will not necessarily respect the line of control in efforts to constrain infiltration. Any escalation of tensions could lead quickly to widespread conflict. Under plausible scenarios Pakistan would

use nuclear weapons to counter success by the larger Indian conventional forces, particularly given its lack of strategic depth. The consequences would be dire. Suggestions that the Kashmir dispute was escalating would, however, quickly attract intense international pressure designed to defuse the situation. Both principals appear to rely on such international intervention to prevent a crisis from spinning out of control.

18. Similar tensions would arise were elements in Pakistan to support more militantly Islamist groups that might emerge from within India's Muslim community, especially in response to Hindu chauvinism.

19. Pakistan will continue to monitor the situation in Afghanistan carefully and would intervene were it to perceive a sufficient threat, especially had international forces left the country. Indian links with elements of the Northern Alliance are an exacerbating factor for Pakistan.

20. Conflict involving other states in the region is less likely but India might intervene in Bangladesh, Bhutan or Nepal if it felt vital national interests were at stake. The likely reaction of external powers, especially China, would be an important element in Indian decision making in the lead up to such action.

### **External relations**

21. The changing international situation after the cold war, the aftermath of its nuclear tests and the gradual opening of the Indian economy have been accompanied by some redirection of Indian foreign relations. This is probably most noticeable in its efforts to build stronger links with East Asia, including China. It clearly wants to be an integral part of a wider Asian region with which it sees economic synergies especially with China. It has also sought to be more open to western countries, especially the United States, and seems to be taking less rigidly dogmatic lines in international forums. India seems intent on playing a more active international role. Links with the Middle East, particularly Iran, have been pursued both to help ensure access to oil supplies and to counterbalance Pakistani ties with the region. These trends are likely to continue and will be driven by very active pursuit of perceived Indian interests, including a desire to wield influence more in keeping with its size.

22. While India remains wary of China, the complementarity of their interests suggests that relations are more likely to improve than to deteriorate sharply in the period to 2020.

23. Prior to 11 September 2001, Pakistan was relatively and increasingly isolated from all but the Sunni Middle Eastern states. The campaign against terrorism has given Pakistan renewed relevance to the United States but the relationship seems fragile. Pakistan is likely to continue building links with the Middle East, especially Sunni countries. Sales of military equipment, including weapons of mass destruction technology would meet the perceived needs of purchasers and provide export earnings for Pakistan. Unlike India, it will play no more than a regional role.

### **The drivers**

24. All of the drivers identified in Global Trends 2015 may have profound effects on the South Asian region in the period to 2020.

- The **demographic** transition currently underway in the region will result in population increasing by 31 percent between 2000 and 2020, compared to about 60 percent in the preceding twenty years. But pressure on resources will intensify, albeit more slowly. Dependency ratios will drop as families have fewer children. Taken together with increasing educational achievement the result will be a larger, more skilled labour force. If job opportunities do not open up, unemployment, particularly of well educated workers, could be a threat to social stability. HIV/AIDS increases the uncertainty of these projections.
- Pressure on **natural resources and the environment**, particularly land and water, will intensify as populations increase and water sources are increasingly polluted. That could intensify tensions within and between countries.
- **Science and technology** have played important roles in recent Indian growth. The growth of a computer industry oriented to providing services for export is the most notable example but there are others, including low cost vaccines and pharmaceuticals. We expect that trend to remain important and to involve a broader range of products. Science and technology may also provide some increase in agricultural productivity and reduce the demand for irrigation water. Potentially, that could lift incomes among the rural poor and reduce some political pressure against reform policies that could lift overall growth.
- Most South Asian countries have become more integrated into the **global economy** in recent years. For instance, Indian exports of goods and services grew about twice as fast as GDP between 1991 and 2001. But South Asian countries have not been seen as particularly attractive destinations for foreign direct investment. We expect that the links between South Asian economies and the rest of the world will



further intensify in the years ahead but the process will vary both by country and over time.

- **Governance** is likely to remain a significant problem in all South Asian countries. Inefficiencies and other problems in administrative and judicial systems undoubtedly have very substantial costs. Executive branches are neither strong nor stable and often subject to the wishes of powerful vested interests. This severely constrains their ability to introduce and implement better policies. The few arrangements designed to build co-operation between regional countries are not particularly effective. India, in particular, is seeking to build its connections and influence in the wider Asian region and is likely to play a more realistic and effective role in multilateral organisations.
- **Conflict** in South Asia over the period to 2020 could be at several distinct levels. Militants, supported from within Pakistan, will continue to use relatively low level violence to challenge governance arrangements in Kashmir. There would also seem to be a risk that Indian Muslims, under pressure from Hindu chauvinism and influenced by Islamist ideology may, possibly with external assistance, resort to violence. At the other extreme, tensions between India and Pakistan could rapidly escalate into a conflict that might see the use of nuclear weapons. Some level of conflict is likely to continue in Afghanistan as the ethnic groups compete for territory and influence. There are a number of other possibilities for conflict within and between states in the region.
- As India has become more integrated with global systems its interests have become more congruent with those of the **United States** and it has been inclined to build closer links. That process was, to a limited extent, interrupted by the role that Pakistan was and is playing in the campaign against terrorism. The underlying trend is likely to continue but India will resist what it sees as inappropriate pressure. And it will jealously guard its influence in the region. The United States, along with other countries, would actively seek to avert any pending war between India and Pakistan.

25. The drivers used in Global Trends 2015 provide a good explanation of most expected developments in South Asia to 2020. It would seem, however, that the set would be enhanced by the inclusion of a driver that directly addresses clashes of ideas (ideology or religion). This has obvious relevance to Islamic terrorism but, in the South Asian context, could also be applied to Hindu chauvinism. It could also be used in a secular context in some disputes over economic organisation and governance. The conflict driver picks up some of the consequences of clashing

ideals but the resort to violence is often preceded by a long period of increasingly acrimonious debate and agitation.

26. Developments in South Asia also suggest that regional architectures are changing. Closer links between India and East Asia reflect the growing economic importance of East Asia and moves by countries in that region to build coherent regional structures. This process is by no means as advanced in Asia as it is in Europe and North America. There are signs of similar tendencies in South America. The underlying changes in trading patterns can be attributed to the globalisation driver, but there are elements of recent moves to regional economic arrangements that reflect dissatisfaction with the multilateral system. That would not seem to justify a separate “regionalisation” driver but is a factor in the operation of the globalisation driver.

### **Wild cards and surprises**

27. Both Hindu chauvinism and the spread of militant Islamist ideology could lead to much greater division in Indian society. Our understanding is that militant Islamist influence in the Indian Muslim community (outside Kashmir) has, until now, been surprisingly modest. These forces could interact to reinforce each other. The results could include large-scale dispossession of Muslims and population movements, and widespread terrorism in India. A more authoritarian (probably Hindu dominated) government could emerge, almost certainly from within the parliamentary system. Economic performance would undoubtedly deteriorate markedly, even in areas not directly affected by inter- communal violence.

28. A sharp rise in Islamist influence in Pakistan, including over the military, could lead to the country becoming an officially sanctioned base for Islamic terrorists. This could, potentially, lead to a much more potent terrorist threat than has hitherto existed. At its most extreme, it could give Islamic terrorists access to well-developed weapons of mass destruction. Short of such a situation, terrorist access would, at most, probably be restricted to knowledge passed on by skilled sympathisers from within the system.

29. It is not clear that either Pakistan or India would survive as a viable state following a nuclear exchange. Natural disasters and disease (including potentially HIV/AIDS) also have the potential to severely disrupt South Asian countries.

30. A sharp increase in the pace of economic restructuring could lift growth rates in India (and in other regional countries) provided that domestic and regional tensions are managed satisfactorily.

The possibility of Indian growth rates by 2020 emulating those in China over the last two decades or so cannot be ruled out. That would, undoubtedly, further boost India's role in the world and Asia.

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